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## STATE-LED TRANSFORMATION AND ECONOMIC GROWTH IN CENTRAL ASIA: FROM PLAN TO INDUSTRIAL POLICY

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### *Abstract*

The article explains differences of initial conditions between countries of Eastern Europe and the former USSR, and argues that: 1) the strengthening of sovereign states in the latter has objectively been the first priority since their independence, the speed and sequence of market reforms and the opening economy has been subordinated to this task; 2) the pace and character of the reforms depends on the specific circumstances in the country, but their respective economic and social costs is the main criteria; 3) economic growth both negative and positive in a new independent country is the cumulative result of various factors, and could not be explained as the sole outcome of transition. Analysis of reforms and economic growth in five independent states of Central Asia proves these arguments and gives evidence, that state-led gradual transition and integration to the world market in Uzbekistan has been the least costly and more fruitful in terms of economic growth and sustainable human development.

### *I. Introduction*

About a decade passed since the republics of Central and Eastern Europe (CEE) and the former Soviet Union (FSU) have embarked on market reforms and faced a number of acute problems. One of them is decline of production within the transitional process. All these countries have suffered from a tangible output drop, and even by now, with one exception, have not yet reached the pre-transition level of their GDP (see, table 1).

Diversity of performance between different countries is so tangible that it is impossible to explain success or failure, or the progress of reforms only by examining the level of GDP. Even Poland's case, which is seemingly a good example for such correlation, should not be taken fully, because in comparisons with other countries in transition it had suffered decline before 1989. And if one compares its current GDP with its real, pre-decline period, the index will be not so impressive. The level of GDP of the Czech Republic and Slovakia (98%), Lithuania and Turkmenistan (43%), Estonia and Albania (78 and 79%) are equal or almost the same. But it is well known that the progress of reforms within these pairs of countries is completely different.

It is obvious that decline was much larger in the Commonwealth of Independent States (CIS), individually and as a group, compared to the states of CEE. According to the European

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TABLE 1. REAL GDP GROWTH IN CEE AND THE FSU, 1989–1997 (%)

|                     |                 |                   |
|---------------------|-----------------|-------------------|
| Poland – 112        | Uzbekistan – 87 | Turkmenistan – 43 |
| Czech Republic – 98 | Estonia – 78    | Azerbaijan – 40   |
| Slovakia – 98       | Belarus – 71    | Tajikistan – 40   |
| Slovenia – 98       | Kyrgyzstan – 59 | Armenia – 38      |
| Hungary – 90        | Kazakhstan – 58 | Ukraine – 37      |
| Romania – 82        | Russia – 57     | Moldova – 35      |
| Albania – 79        | Latvia – 56     | Georgia – 32      |
| Bulgaria – 63       | Lithuania – 43  |                   |

Source: EBRD, “Financial Times”, August 5, 1998

Bank for Reconstruction and Development (EBRD), for the CIS this index was equal to 44%, while for all countries in transition given in the table the GDP as a whole in 1997 output drop was 29% in comparisons with 1989.

In all republics of the CIS systemic economic crisis followed the disruption and shocks of economic liberalization, and was much deeper and more destructive than in CEE, as a result, at least, of four main causes.

(1) Historically, the administrative-command system in the FSU was more rigid and lasted several decades longer. Almost all generations of the society were born in the Soviet period. There were not any tangible market institutions left in the country that had existed before establishment of the centrally planned economy (for example, in Poland the pre-1939 commercial code capable of enforcing contracts was just re-introduced even before the start of transition in 1989). Although, some native ethnic groups of the Russian Far East and Siberia had experienced a mainly pre-capitalistic stage of market relations, in most Central Asian nations no modern institutions of the market economy ever existed in their historical heritage. Under Russian and Soviet rule, all central governmental and economic bodies were located in Moscow. Real national statehood, comprehensive national institutional systems (including Central Bank, laws and etc.) had to be created only after independence and from the scratch. (2) Economically, on the other hand, the Soviet republics had become in 70+ years the most integrated entity inside the multinational state, and the most isolated from the outside world, much more than the COMECON economies or any other regional group of developed or developing countries. The break up of the system itself brought huge additional economic shocks, which needed specific policies and tremendous efforts to cushion. (3) Politically the impact of the disruption of the FSU was also strong, no new republic had real and fully-fledged statehood, including Russia, which had dismantled the Soviet state, but could not build -up a new efficient state yet. (4) Technologically, a Soviet version of the “Dutch disease” based on abundant oil, gas, metals other mineral resources and hyper-militarization under Brezhnev’s rule, among other factors led subsequently to deep economic stagnation in the 1980s of major sectors and contributed to an overall crisis in the 1990s. New states after independence inherited all the problems of an unbalanced economy and found many enterprises packed with obsolete equipment and old-fashion technology or requiring large investments to convert military production in addition to impact of the disruption of technologically connected large state-owned enterprises of former all-Union amalgamations.

So, all newly independent countries faced the various challenges and shocks in addition to systemic transformation and integration in to the world economy. And decline in a CIS

country was a cumulative result of all these and other factors. Decline is not, as a rule, the sole outcome of the transition and reallocation of output according to market signals. Therefore, the speed of recovery and high rate of growth after decline is also difficult to take as the only proof that a country cut off all inefficient production and now has better economic environment conducive for business activities. According to the CIS Statistical Committee, f. e., in 1997, Belarus and Kyrgyzstan had one of the most dynamic growth in the CIS, with about equal annual rates. But again it is common knowledge that both countries are almost polar opposites in the introduction of market reforms.

From the normative neoclassical position adopted by proponents of shock therapy countries in transition which have introduced the whole reform package should be better off in respect of economic growth and social development as well. The experience of Russia, the biggest of the CIS countries, which rather straightforwardly adopted the "shock therapy" prescriptions has not yet proved the fairness of radical economic reforms introduced without proper adjustments of the basic assumptions. The predicted "coming Russian boom" could have not been easily seen so far ahead. With the state falling apart under financial and center-region relations crises, radical reforms brought huge economic and social costs with no real benefits to the vast majority of Russia's population, and liberalization added shocks to the enterprises which lost any hope not only to increase efficiency but even survive. Only the shadow economy has been growing and bringing extremely distorted and semi-criminal market relations.

The main policies of the recommended package and hastily followed by Russia and some other CIS countries were the same as to the CEE states:

- 1) destruction of the existing state apparatus as the center of not only political but economic management as well elimination of all regulatory functions of the government as much and as soon as possible;
- 2) radical, forced, without proper preparations and reliable social safety nets, economic liberalization, stabilization, and privatization;
- 3) overall and fast opening up of the economy in order to enhance its real sectors through international competition.

In this paper, I argue that this kind of policy, that had proved itself relatively successful in some states of CEE, was not suitable for the most of the CIS countries without proper adjustments. They had differences not only in their initial conditions but more complex tasks of the transformation that included also the formation new sovereign states. So my first argument is: state building with the right fundamentals and policies within a systemic transformation in a new independent country is the first priority and other two major priorities—transition to the market and integration to the world economy—should have been subordinated to it. Therefore, if in the CEE countries the transition to the market and opening up were the main priorities, in the NIS in reality it was to build up a new sovereign state to make systemic transformation possible. Reforms to promote strengthening, not diminishing, of the state making it able to adopt a tailor-made strategy of transition, to shift from a plan to industrial policy and introduce gradual market reforms and opening up of the economy—were more appropriate for many of them.

Secondly, I argue, that the focus of the debate is not only radical or gradual reforms, but their respective economic and social costs. The path and sequence of market reforms and the

opening up of the economy depend on the specific situation in the country, but most importantly: their implementation should not be conducted at the expense of the real economic sectors and unjustifiably adverse effects on the achieved level of human development.

Thirdly, to understand better what is behind the growth in each case it is necessary to examine more thoroughly country by country the peculiar features of the reforms and their impact on economic and social indexes. The mix of factors, which really has provided negative growth in various countries, is different. Positive dynamics have appeared in some of them within the last two years also need special analysis to identify their sources and evaluate whether the growth is sustainable or not.

Therefore, the assessment of the strategy and performance, as well as of initial conditions should not be one-sided and requires a multifaceted approach. Macro- and micro- economic analysis of the market reforms (liberalization, stabilization, privatization and institutionalization) needs to be complemented by a comprehensive study of the political economic, social and international aspects of their real progress and impact on economic growth, social development and integration to the world economy.

The main focus of this paper is an analysis of the performance of five Central Asian states in transition-Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan. Despite common cultural and historical backgrounds, including the Soviet period, after their independence they found themselves with different abilities to cope with the problems of systemic transformation and integration into world economy and choose different priorities and strategies of transition. Among Central Asian countries today, there are early and late starters, the most vivid cases of "shock therapy" and "gradualism" in the CIS. The reforms and economic growth in Uzbekistan are taken as a principal case model. It provides evidence for an alternative pattern and proves the novelty of the arguments in favor of state-led systemic transformation, rather than merely a transition to the market, based on ideas of purely monetarist neoclassical theories, with a minimal state.

The next section is devoted to clarification of the initial positions of transition from political economic viewpoints. It argues that the state plays the key role in systemic transformation, not self-liquidation but a shift from an administrative-command to a development-oriented system, from plan to industrial policy, and that this is crucial for the success of reforms. Sections III and IV provide details of market reforms and economic growth in the independent states of Central Asia. They also show that a country that pursued state-led transformation with a gradual and balanced strategy and its proper implementation, has been passing through the same reforms and shocks of disruption with the least costs, and building up its industrial base, better than other NIS. And the concluding section, V, shows the high costs of shock therapy reforms in Central Asia in terms of their social and international aspects.

## *II. Political Economic Aspects: The Role of State in the Transition Economy*

A political economic approach to systemic transformation has been lacking so far in both scholarly research and applied policy analysis publications. To a large extent macro-, and to a lesser degree micro-economics have been the predominant tools for the study of countries in transition. However, they, with their emphasis mainly on the mechanism of the functioning of

a mature market economy at macro- and micro- level, cannot substitute political economy with its focus on the origin and sources of development of different processes and the causes of their transformation. The former are preoccupied with regularities of coordination of relations at a certain stage of market development, and the latter with the mechanism of evolution from one level of economic development to another. Both approaches are complementary, they represent horizontal and vertical slices of analysis of the same processes, exaggeration of one of them could lead to the loss of the necessary balance needed for comprehensive research and policy recommendations.

In the opinion of the author of this paper, the economics of transition, now emerging as comparatively separate subject with a new area of economic study, is suffering with an overemphasis on macroeconomics and an understatement of political economic analysis. In practice this has meant overemphasis of common and stereotypical tools of macroeconomic stabilization and restructuring at the expense of the comprehensive consideration of the peculiar roots of each individual economy. In addition, priority has been given to short-term objectives over long-term strategic goals of development.

So far, almost ten years since the crucial political changes which started in Eastern and Central Europe and followed the disruption of the FSU as a multinational state and political system, there is no clear cut understanding of the principal goal of transformation and the means how to achieve it. From the beginning of the reforms till now the most widespread definition of 'transformation' is transition to the market. But this is not a final goal, it is a general precondition necessary to achieve it. What kind of market economy is aimed at?

In the FSU, —beginning with "uscorenie" (acceleration of economic growth) and "perestroyka" (economic restructuring), Gorbachev wanted to use the market as a complementary instrument to the centrally-planned economy to make it "à la Chinese reforms" but with more crucial changes of the political system- "glasnost" (openness) and "demokratizatsiya" (democratization). Both the ordinary Soviet people, and the political and intellectual elite believed that the shift to a market system would be easy and fast (f.e., "500 days program") and would cure all the problems of the FSU, both economic and inter-republic. The actual intention was to reach better international competitiveness and to increase efficiency of production, giving more incentives for people to work harder and be more productive to earn and live better. It was also expected to give the FSU a new strength to catch up highly industrialized countries. The assumption was that the FSU almost achieved the standards of the most developed countries before its stagnation in the 1980s and then the gap had increased. This was attributed to the fact that new technologies required less rigid, not centralized and administrative-command methods, but a lot of flexibility to motivate a sort of Schumpeterian innovative entrepreneurship [Schumpeter, (1952, p.72)]. So, the "idealistic goal" and the hidden agenda were to obtain more efficient and flexible infrastructures, increase productivity and living standards and shift to a contemporary socially-oriented market system based on modern industrial technologies and structures with a welfare state.

The failure of the Soviet model of the centrally-planned administrative-command system designed to "catch up" and overcome industrialized economies highlighted the necessity of the transition to the market, on the one hand, and the impossibility of doing it within the existing system, on the other hand. The chance to introduce these reforms required a fundamental economic transformation, but it coincided with political disruption in the FSU. In the Post-Soviet independent states, which have undertaken systemic transformation in a new

political environment, the transition to the market became the essential part of it. It was understood in a majority of them, that the market and a mixed economy with competitive forces based on different forms of property, including comprehensive private ownership, is a necessary condition to achieve higher level of technological development and incomes. It also became clear that the goals of the reforms would not be achieved quickly and easily.

Moreover, "realistically" the transformation to a modern industrialized market economy for each republic of the FSU, because of different levels of development (living standards, economic structure, the level and character of industrialization) is different, will require different lengths of time and can be achieved in long-term perspective. For the Baltic states, the immediate goal was to overcome economic recession, then in the mid-term to catch up the advanced Eastern European countries in transition and also become part of the European Union. For most of the Central Asian states, the goals are different: not to fall to the level of low-income developing economies in the short run. In the medium term, to complete the transition from an agrarian to an industrialized economy and to strengthen their positions among the group of middle income countries; to catch up, for example, the East Asian newly industrialized countries and join the industrialized high-income countries in the longer run. Different countries in the same group have rather big variations in their objective and subjective potential to achieve these goals.

It meant different strategies, and different models of transition were needed. A few years of reforms showed that the market is a necessary condition for transformation, but it is not a sufficient one without a strong state. An efficient state able to deliver its traditional functions (provide public goods, basic social services and infrastructure; protect vulnerable people and the environment, establish the rule of law and order) and play a new role connected with transition is critical for the transformation. Therefore, the leadership abilities of new states to adjust common tools of transition, adopt a tailor-made strategy and implement it, has become the significant factor for systemic reform and economic growth. And the success or failure of reforms, (measured by the level of social and economic recession in the NIS) to large extent was a result of the efficiency or in-efficiency of governments, their capacity to choose the right goals and achieve them at the right time.

The main peculiarity of the post- socialist state is that it is itself in transition from overall dominance over society and economy to fair and democratic redistribution of its functions between government and the market. The dialectic is: to introduce market relations and restrict state intervention into the economy to cure state failures by new market instruments; and, on the other hand, to prevent within the transition process any uncontrollable growth of market failures. Building up such a new state has become the top priority to:

- create a catalytic environment for a new macroeconomic order based on market relations, and ensure its stability;
- diminish and eliminate any negative consequences of the old system with its deformation of economic behavior, inefficiency of production, regional and sectorial distortions;
- form a new institutional and legal framework (private property rights, contractual law, corporate and antimonopoly law, commodity and stock markets, etc.);
- initiate privatization, support small and medium private enterprises and provide transparent restructuring of large-scale state-owned enterprises;
- promote a favorable business environment both for local and foreign investors;

- introduce a new mechanism for foreign economic relations.

All these and many other important and urgent tasks require not self-liquidation of the economic role of the state, but strengthening of it by avoiding old habits and weaknesses and obtaining new skills, cutting unnecessary expenditures and focusing on solving the most significant problems: less costly and more efficient government, able to deliver at least the fundamentals and match its role to its capabilities. Both tasks could be better achieved on the basis of "step-by-step" transition rather than in a "big-bang", because it gives greater opportunity to choose and concentrate on the most important targets which are not beyond the capabilities of the state. Its fundamental purpose is to make as much as possible more to achieve realistic goals, rather than to be involved in over-ambitious wishful, but not feasible projects.

The latter was one of the main reasons of the series of failures at the initial stage in almost all CIS countries: the disproportion between the tasks of the "shock therapy" type of transition and the weak newly independent states, to manage rapid and overall lacking the capacity reform. As a result, in many of them the governments lost control of the situation and could not deliver not only comprehensive reform but even simple public goods. To adopt and implement a proper strategy was the key factor to cushion shocks not only in the transition but also in the disruption of the over-centralized and extremely integrated Soviet economy.

A transition strategy based on pure liberalism, free interplay of market forces and elimination of all regulatory functions of the government with minimal participation of the state in economic management has not yet worked in Russia and many other countries of the CIS. Destruction of the existing ties controlled by the central government was not followed by the spontaneous creation of new ones between efficient corporations and private individual owners operating under market rules. Instead we have seen economic anarchy, with gigantic arrears, according to estimates, in Russia at about 35% of GDP, [*Financial Times* (26 August 1998)]. Distorted relations have developed between a state with no real ability to collect taxes and privatized corporations with a huge part of the shadow operations ranging from officially 25% (Russian Goscomstat) to 50% (World Bank) of the registered Russian GDP [Havlik in Rosati et al (1998, p.59)]. Financial scandals and this unfavorable business environment have resulted in a massive capital flight from Russia.

To demolish the old state and transform to a market overnight or by decree might be wishful, but has proved to be neither realistic nor feasible. Even partial disruption of the old structures without introduction new, more effective tools dealing with respective processes created in many cases not positive, spontaneous growth of market forces, but a destructive anarchy and criminalization of the economy. Diminishing the regulatory role of the government and increasing beneficial and self-managing market forces is not only a long but a controversial process. For example, there are simultaneous pressures from people and different lobbyist groups on the government to cut taxes and, on the other hand, to increase subsidies.

Another alternative was a steady and gradual transformation from the over-centralized administrative-command system based on common national property to a mixed market economy by strengthening the state and the thorough implementation of a consistent and gradual strategy of transition. Comprehensive consideration of the peculiarities of their initial conditions, and the degree and character of economic interdependence within the FSU were also vitally important. Fostering market relations, supporting private sector development and



making maximum use of inherited human resources, as well as real economic and social infrastructures to develop and manage respectively a dual track economy under the transition process have become instrumental pillars of state-led transformation [see, Islamov (1997)].

Transition to the market in newly independent states requires internationally-tested and efficient policies, and among them first of all an industrial policy. As is known from the practice of an economic reconstruction in Western Europe (Germany, Austria, Belgium, the Netherlands, France) and Japan after World War II, as well as subsequent economic development in some other East Asian countries, industrial policy can give impressive results. The outcomes of industrial policy conducted immediately after reconstruction were as a miracle with 12.9% average annual industrial growth in Germany for the period of 1948–1960, and not less impressive growth in Japan a decade after. At that time, public savings were used for investments in priority sectors of the economy, both industries and agriculture, and protectionism provided the possibility not only to restore but also orient them to export and promote them to the level of international competitiveness. At some point such policies required bigger budget expenditures and deficit financing. And increase of public investments was accompanied by some monetary expansion. The main lessons from these success stories is that rigid fiscal and monetary policies should have reasonable limits and should not ruin the real economy and prevent the build up of potential for economic growth.

Countries in transition are able, and have, to use elements of industrial policy starting from the initial stage. For example, according to K. Laski, it was necessary to conduct an “aggressive industrial policy” to counterattack diminishing demand, a sharp increase of credit hunger and the liberalization of imports, that lead to “inertial factors” on the supply side - closure of enterprises, underutilization of production capacities, disqualification of human capital. It was not possible to eliminate such negative trends only by market incentives under macroeconomic stabilization policy [see, Bhaduri Sh. et al. (March, 1993, p.70)]. Even stereotyped stabilization programs, therefore, had to be more flexible, as for targeted rates of inflation and budget deficits, to the specific needs of the each country. To a much greater extent an individual approach is important for privatization measures. No success from any kind of restructuring could be expected if it does not conform to peculiarities of the economy and readiness of the state and society to support and conduct it properly.

The World Development Report, 1997, on the basis of overall analysis, eventually admitted that the state, by playing more constructive rather than destructive role, had to prevent a vicious circle: “Under which people and businesses respond to deteriorating public services by avoiding taxation and that leads to further worsening in services”. But an even more significant task of reform is to contribute to a “virtuous circle: when small improvements in the state effectiveness lead to higher standards of living, which in turn paving the way for more reforms and further development”. It also criticized the “minimalist approach to the state” and promoted the idea of “an effective state, one that plays a catalytic, facilitating, encouraging and complementing the activities of private businesses and individuals”. And stressed, that “the task of matching role to capability is especially difficult when both are under transition and changing rapidly”. Nevertheless, the necessity of “maintaining existing centers of excellence” and “providing the population with the mechanisms of social protection to which they are accustomed” is emphasized. The economic ability of the state to form sound policies and institutions, and to conduct industrial policy is recognized as the main factor both for development and transition. [World Bank (1997, p.p. 1–15, 29–30, 167)].

Countries in transition will benefit a lot, if International Financial Organizations (IFO) use these ideas in a coordinated manner among themselves and with the respective states in their practice and policies oriented on further market reforms. With proper adjustments of their recommendations to the realities of different countries in transition in terms of timing, speed, sequencing and implementation, as well as with more flexibility in introduction of the basic conditions, IFO could become more attractive and efficient. And this will permit them to play a more instrumental role in achieving the goals of transformation in the newly independent states too.

Central Asian countries, the least developed part of the FSU, after independence faced the problems common not only to countries in transition, but also to developing states. The strategy of reform, therefore, had to deal both with the transition and development. Objective analysis of world experiences of "catch up" models indicates that this group of countries could learn from East Asia the main lessons of their success, including industrial policy with outward orientation, and adjust these to their own circumstances. On the other hand, at the initial stage of transformation, state-led transition and development could be easier and more appropriate than radical reforms. Combination of state regulation and a growing role for the market after the pattern of the newly industrialized countries, with more market institutions and consonant popular behavior could be natural step towards a more mature and free market economy in the future. But today to achieve this level and to match both tasks of transition and development in the post-socialist countries of Central Asia, the state and its economic instruments should be strengthened and reformed first of all. The main direction should not be the destruction of the state and deregulation of all its economic functions, but its transformation from an administrative-command to a developmental state and from plan to industrial policy.

Thus, the role of state under transition is not diminishing but changing. In addition to the ordinary functions connected with delivering public goods, government becomes responsible for fostering and promoting market reforms, neutralizing the negative by-products of systemic transformation and creating a conducive environment for economic growth and social development. For a newly independent country these tasks are complemented by the urgent needs of building effective national statehood and market institutions from scratch. Sustainability of growth in the coming stage of reform will depend to large extent on the soundness of the state to foster market forces and complement these in appropriate way.

### *III. Macro-economic Aspects: Progress of Market Reforms in the States of Central Asia*

#### **1. Liberalization and Macro-economic Stabilization**

Central Asian countries, like all newly independent states in transition, from the beginning of their existence faced an overall crisis aggravated by sharp disruption of the FSU. In addition to collapses in output and trade, they had to deal with the two most acute problems: the rapid increase of inflation which accompanied price liberalization, and the huge state budget deficit, which required urgent measures of macro-economic stabilization.

### *Price Liberalization*

The first set of reforms aimed at replacing the fixed prices of producers by contractual ones (January, 1991) and liberalization of retail prices, apart of prices for top necessities (April, 1991), was launched in the FSU under Gorbachev. Comprehensive price liberalization was announced in Russia by Yeltsin in October 1991 and introduced in January 1992. It was radical liberalization that involved 80% of producer prices and 90% of retail prices. Despite the political dissolution of the FSU in December 1991, the economic impact of the latter was very strong on all countries of the ruble zone because of their very tight interdependence.

All new states of Central Asia, faced the consequences of these measures practically from the cradle of their independence. The first reaction was to protect their populations and preserve social stability.

Kyrgyzstan for a short while tried to keep state subsidies for bread, meat, coal and public transportation. But it soon replaced the subsidies by the direct payments to the most vulnerable strata of the population. In Kazakhstan prices for major necessities had been kept for about three years. And only in October 1994, the new Government of Kazakhstan abolished almost all subsidies, keeping only few utility prices under its control. Uzbekistan adopted more gradual approach. Price control abolition was largely phased out within 1992–1995. A system of cards to provide at least minimum quantities of the basic goods to every family at subsidized prices was temporarily introduced. Liberalization of prices was practically completed by early 1996, with the prices of only a few communal services and monopoly products, and some rents, remaining subject to control. In 1996, domestic wholesale prices for oil and oil products had increased to world-market levels. However, difficulties (in agriculture, the cotton crop decreased in 1996, combined with lower prices for it in the world markets) affected the state budget and the financial situation in the republic, and at the end of 1996 and the beginning 1997 some setbacks occurred in economic liberalization. In Turkmenistan the majority of prices were kept under state control longer than elsewhere in the FSU. Not until the year 1996 was there a year of “fundamental reforms”. In Tajikistan reforms started in 1992, were interrupted by civil war and it will require time to resume them properly.

### *A Rapid Inflation and Its Recent Status*

The first five years of transition in Central Asia like elsewhere in the FSU were characterized by sharp price increases. This was complemented by huge monetary expansion, especially in 1992–1994, which lead inevitably to hyperinflation. The peak figures for inflation in Kyrgyzstan (1209%) and Tajikistan (2195%) were in 1993, and in Kazakhstan (1980%), Turkmenistan (2400%) Uzbekistan (746%) in 1994 [World Bank (1996)]. In Uzbekistan this index was less than elsewhere in Central Asia, compared to both radical (Kyrgyzstan and Kazakhstan) and late reformers (Tajikistan and Turkmenistan). So, slower reforms do not always mean higher inflation; late or no macroeconomic stabilization and structural adjustments do.

The governments of Kazakhstan, Kyrgyzstan, and Uzbekistan have managed in 1994–1996, due to tight monetary and fiscal policies, to decrease inflation tangibly. In 1997, inflation was 20.4% in Kazakhstan, 25.5% in Kyrgyzstan, 30% in Uzbekistan [ADB, (1998, p.p. 72–79)]. Turkmenistan after having in 1996 one of the highest inflation rates in the FSU - 992% - managed to decrease annual average inflation to 83.4% in 1997. It still remains higher in Tajikistan, the 1997 year end rate was 164% [EIU (2<sup>nd</sup> quarter, 1998), Turkmenistan (p.p.8,

21); Kyrgyzstan, Tajikistan (p.32)].

It is worth noting that the real possibilities to conduct macro-economic stabilization measures appeared in all Central Asian states only after disruption of the ruble zone. In Uzbekistan, the introduction of a fully-fledged national currency on July 1, 1994 became instrumental for conducting independent economic stabilization policies. The Central Bank of Uzbekistan in 1995–1996 raised interest rates on its rediscount credits and shortened credits to loss-making state enterprises. The government cut subsidies and tried to pursue a hard budget constraints policy towards state owned enterprises. But it avoided an extreme policy to curb inflation at any cost. Reforms were oriented towards protection of people and real economic sectors as much as was possible.

### *Problem of State Budget Deficit*

The overall economic crisis, sharp contraction of production and intra-FSU trade, with the subsequent huge decline in GDP resulted in a tremendous fall of state revenues and huge budget deficits. Even in Uzbekistan, which suffered the least decline of GDP in the CIS and managed to avoid a catastrophic collapse of revenues, within period 1991–1994 average annual budget deficit was as high as 6% of GDP.

Since 1995 in case of Uzbekistan, (1996-Kazakhstan, 1997-Kyrgyzstan) the budget deficit has been brought to more or less acceptable size. According to the Asian Development Bank, these three republics of Central Asia in 1996 and 1997 had the following levels of their state budget deficit: Kazakhstan, due to the rigid fiscal policies in 1996, managed to decrease its state budget deficit substantially, to 3% of GDP. However, the need to mitigate a deterioration of social indicators did not permit to maintain this level. In 1997, the deficit was over 4% of GDP. Kyrgyzstan reduced the deficit from 5.6% in 1996 to 4.5% of its GDP in 1997. It was connected with economic expansion, fiscal consolidation and improvement of tax administration. Uzbekistan in 1995–1996 had a deficit around 3.5% of its GDP, and decreased it to 3% in 1997. It was a direct result of new measures undertaken by the government: increases in value-added, property, land, and mining taxes, the introduction of a new ecological tax on the assets of all non-agricultural enterprises and a tax on enterprises' gross sales. Reduction of expenditures on defense, state administration, and water and electricity subsidies also contributed to the improvement of the state budget. Despite budgetary constraints, the government allocated additional resources for capital expenditures and social services [ADB, (1998, p.p.72–79)].

Taxes became the principal source of state revenues. In 1991, their share in budget revenues of Commonwealth of Independent States (CIS) was in the range of 10–25%. By 1996, in Uzbekistan they reached 87.0%, which was more than in any other republic of the FSU (for comparison: in Turkmenistan-67.2%, Belarus-66.6%, Russia-63.0%, Ukraine-57.0%, and Kazakhstan-37.8%). At the same, time the share of state expenditures of Uzbekistan on social and economic development was higher than in other countries of the CIS [CIS (1997, p.11)]. The better fiscal situation in Uzbekistan in comparison with other countries in the CIS, was connected with higher revenue collection and with less output decline for the whole period starting in 1992.

Thus, after the introduction of the national currency, the sum, in July 1994, as was also recognized by the IMF, Uzbekistan embarked on a comprehensive stabilization and economic reform program. While the basic features of this program were similar to those programs

established by other CIS, the pace of reform chosen by the republic was more gradual than in most [IMF, (1997, p.5)]. As for the speed of reforms within Central Asia, it was just in the golden middle. The republic managed to cushion shocks better, than two other countries that were faster, and avoid the bigger costs of delayed reforms taken place for different reasons in the other two neighboring states. It has also chosen a better combination of fiscal and monetary instruments for macroeconomic stabilization, relying more on the former and not trying to achieve low inflation by extra rigid monetary policy at the expense of the real sectors.

## 2. Privatization and Market Institutions

In 1991–1996, the share of workers employed in the public (state) sector decreased in all CIS countries to 47.0%. Currently, the private sector of Kazakhstan, Kyrgyzstan and Uzbekistan has bigger share of total employment than the private sectors of other newly independent states. Non-state enterprises in these countries provide 90–95% of consumer goods turnover in the domestic markets (which is comparable with Russia and higher than in other NIS) [CIS (1997, p.10)]. These Central Asian states adopted their respective laws on privatization as early as in 1991. Despite the fact that these countries began at the time, the pace and methods of privatization were different, although they tried to learn from each others experiences, both the positive and negative lessons.

Kazakhstan started from “voucherization” — even and free-of-charge distribution of national assets among population through vouchers. In November 1993, the Government adopted the National Program of Privatization and introduced new methods: small, mass and case by case privatization. To participate in mass privatization through Investment Funds almost all the population of Kazakhstan was given investment coupons. Unlike small privatization, both voucher (1991–1993) and coupon (1994–1995) stages of mass privatization proved to be not very successful. The practice of case by case privatization of large enterprises and radical changes in management, including transfer to foreign management (developed at a later period), became more attractive, especially from the viewpoint of foreign investors. And in 1996–1997, large-scale privatization was rapidly implemented. The main industrial enterprises were sold to foreign companies. As for private land ownership, it was rejected after long debate in 1994 by the Parliament of Kazakhstan, which adopted a law which stipulated, that land can be leased with a right to be bought and sold, as well as inherited for a term up to 99 years.

In Kyrgyzstan from the beginning the voucher system was combined with cash auctions for privatization of small and medium enterprises. The latter was more efficient. The attempts to introduce voucher system within first two years after independence, though, failed. Even in 1994 most of the vouchers were unused. Therefore, the vouchers were replaced by transferable coupons. The latter did not become popular as well, because people had little confidence in their value. In February, 1996 the government adopted a decree, which introduced, in addition to coupon and cash auctions, competitive tendering for large investment projects, direct sales and long-term leases to investors selected by the State Property Fund. A two-year program of the privatization of 360 medium and large enterprises was announced. As for land use rights, in November, 1995 it was extended from 49 to 99 years. In October, 1998 private ownership of agricultural land with, at least, a five year moratorium on land sales after privatization, was introduced by the Referendum of Kyrgyz Republic.

Tajikistan, in May 1996, despite the chaos in much of the economy, adopted a two-year program, according to which 40% of the country's public enterprises were to be privatized. In 1997, 742 state-owned enterprises were sold to a value about 13 million US dollars. 2500 enterprises are slated for privatization in 1998 [EIU, (2<sup>nd</sup> quarter, 1998, p.30)]. But the process mainly involved small-scale firms, and the success of privatization will depend on lasting peace in the country and its regions. Private land ownership in agricultural areas is not envisaged. Land is assigned either to agricultural cooperatives without the right to resale, or to farmers on a long-term basis.

In Turkmenistan privatization has begun, mainly of small-scale enterprise. By September 1996, about two thousand shops, catering businesses and service rendering small firms had been sold by the government to private individuals and cooperatives. Shops for food remain fully state-owned. At the same time, private land ownership has been permitted by law. The maximum size of plot that can be privately owned is 14 hectares. It can serve as collateral but cannot be an object of trade. In 1995 the private sector produced only about 10% of Turkmenistan's agricultural product [Bairamov J., Badykova N. (1997, p.p.210, 219)].

In Uzbekistan by end-1995, according to its State Property Committee, 85% of all enterprises were privatized or converted into joint stock companies. In these non-state enterprises 65% of labor was employed, 67% of national income produced, 97% of the agricultural product, 91% of the consumer services, 61% of construction work, and about 50% of industrial output were produced. Corporatization started with closed joint companies, which were soon transformed into open joint stock companies, with the state share reduced to an average of about 30%. Almost all state farms were converted to various forms of cooperatives (collective, lease-holding, stock-holding), private and individual farms and farmsteads. In 1996, there was an additional privatization of 1,664 enterprises, including 108 medium and large-scale enterprises. As a result, about 2mln. share owners, 3mln. households got land plots totaling 550,000 ha for personal needs, farmers obtained about 200,000 hectares of land. 97% of state-owned housing has been privatized. Overall, in 1993–1996, 94% of small-scale enterprises and 19% of medium and 17% of large-scale enterprises have been privatized [IMF, (1997, p.67)]. In 1997, Uzbekistan has introduced its own method of mass restructuring through Privatization Investment Funds (PIF). Shares of 300 medium and large-scale enterprises, among which are some of the most profitable ones, were offered via PIFs. The Government is committed to privatize 74% of shares. At least, 30% are intended for PIFs, 21% will be sold through the stock exchange and 23% will go to employees [see, Guliamov, Islamov (1997)].

According to the Ministry for Macroeconomics and Statistics, in 1997 Uzbekistan had privatized more firms than expected (1,231 against an initial target of 1,136) and received revenues from privatization equal to about 0.5–0.7% of GDP. It is less than in Kazakhstan where privatization revenue was 3.5%. [see, EIU: Uzbekistan, (2<sup>nd</sup> quarter 1998, p.16)]. However, this was achieved by selling proportionally many fewer enterprises, mainly not the most important enterprises and with shares more evenly distributed between local and foreign investors. But the problem is not only the number of enterprises and the amount of revenues, the potential for real restructuring in privatized companies will be decisive for the genuine success of reforms.

So, three Central Asian states (Kazakhstan, Kyrgyzstan and Uzbekistan) have been making certain progress in the privatization of their economies. However, it is clear that the

initial transfer of property rights through privatization is only the beginning of the introduction of new incentives for more efficient production based on private ownership. The success of privatization can only come with time when it will be followed by the development and expansion of the capital market to channel scarce investment resources into areas of the highest economic returns.

For that market, institution building is important. By 1996, the majority of exchanges in Uzbekistan and Kazakhstan have been in the wholesale trade of consumer and capital goods. However, in the last two years stock exchanges in Tashkent and Almaty, as well as Securities Exchange Commissions in Uzbekistan and Kazakhstan, have increased their activities. The Government of Uzbekistan together with the World Bank has a project (the total cost of 47.7 million US dollars) to support privatization, including large enterprises and to develop a capital market [RFERL, (29 June 1998)].

Today, in the area of institutional and regulatory reform, the Central Asian republics are working on key issues, including bankruptcy reform, anti-monopoly and general business law reform. A basic legal and institutional framework for financial market development is now in place. A large training effort in all these areas is underway. But further promotion of skills and understanding is needed to ensure proper implementation of all these reforms.

Thus, the advanced three countries of Central Asia introduced a more or less similar approach to small privatization and differ as for large scale restructuring. Uzbekistan avoided inefficient voucher privatization and introduced its own model for gradual restructuring of medium and large-scale state owned enterprises. The pace of privatization will go hand in hand with institutional changes and the readiness of people and businesses, local and foreign, to invest in Uzbekistan's enterprises.

#### IV. *Economic Growth*

Transition to the market was undertaken by peoples of the FSU not as a final goal but rather a means to achieve better living standards on the basis of more efficient production. Therefore, the progress of reforms should not be measured only by degree of marketization. The main point is how market reforms support efforts to achieve economic growth and improve the basis for sustainable human development.

"Friedman's law asserts that physical destruction of capital is the fastest way to growth. Countries with newer capital can take advantage of state of the art technology; the shock of destruction forces rebuilding. Where destruction is absent, there may be no incentive to make a Schumpeterian jump." These ideas of a famous liberal economist were not fully accepted by some other scholars and practitioners of market economics. Taking as an example the growth performance of the postwar period in Western Europe and Japan, R. Dornbusch, W. Nolling and R. Layard put several questions. "First what was actual wartime destruction? One argument is that destruction concentrated substantially on housing and much less on industrial structures and even less on equipment. If so, the high rates of investment meant extra investment, coming on top of a high capital stock. The second question whether the wartime accumulation of capital was very specific to the war effort or else was quite malleable. If the latter was the case, high growth in the postwar period was largely a reflection of significant accumulation over as much as a decade. Finally, how much did shortages, wartime constraints,

discipline, and need teach people to use resources more carefully and stretch their use much further? How much did they learn to just cope and get a job done? Clearly, that too is a source of growth." [see, Dornbusch et al. (1993, p. XI)].

Methodologically, the extent of initial decline (the yardstick favored by shock therapists) is even less acceptable in the case of the CIS. People who had lived under completely different environment, had never experienced a market economy and enterprises, which had not been accustomed to hard budget constraints, could not change their behavior overnight. To destroy existing capacities and skills or to capitalize on what had been accumulated and build up a new framework and give people new incentives making shocks of transition less painful: which strategy is better?

Decline of production without the formation of market institutions does not bring closer and automatically prepare for the "take-off". But it destroys even those capacities and skills, which could be used as a starting point for further development. The laws regulating mature and developing economies are not the same as those for a country in transition. In the case of the FSU, the market institutions and people's behavior should be built up from scratch, but is it necessary to destroy plants and then rebuild them? The postwar experiences of reconstruction in Japan and Europe, despite the obvious differences with countries in transition, can give lessons about the proper use of accumulations of human and physical capital from earlier periods.

## 1. Dynamics of GDP in Central Asia

In the period of 1989–1997, independent states of Central Asia have seen falls in their GDP from 60% in Tajikistan, 57% in Turkmenistan, 42% in Kazakhstan, 41% in Kyrgyzstan, to 13% in Uzbekistan (see, table 1). Among Central Asian states, Tajikistan, following the civil war that erupted in 1992, had the highest average annual negative growth. For the period 1990–1994, it was (–22.5%) in comparison with Kyrgyzstan (–16.9), Kazakhstan (–14.3), Turkmenistan (–5.2) and Uzbekistan (–5.0) [World Bank (1996)]. The sharp decline of GDP in Tajikistan and the worsening of all economic and social indicators, pushed the country into the group of low-income states. As a result of decline, in 1996 the size of GDP in Tajikistan is comparable with the size of its GDP at the beginning of 1970s, and in Kazakhstan and Kyrgyzstan the GDP of 1996 could be compared with the size of their GDPs at the beginning of the 1980s. (For comparison, Russia and Ukraine had GDPs equal to that of the late 1970s, and the CIS as a whole was equal to the GDP in 1977). The scale of decline was much worse than in majority of European countries after WWII and the speed of recovery has so far been much slower.

Starting with 1996, Kyrgyzstan, Uzbekistan and Kazakhstan had positive GDP growth. In 1997, after the cease-fire agreement and the establishment of relative peace in the territory, some small growth was recorded in Tajikistan. But in the same year, Turkmenistan GDP dropped by 23% because of a huge decline in its major industry—gas production and export (as a result of disagreement with Russia on prices, volumes and routes of its transportation). After five years of sharp decline, in Kyrgyzstan there was rather fast growth of GDP in the last two years, especially in 1997. According to the official statistics of Kyrgyzstan, real GDP grew by 10.4% in 1997. However, the latest available IMF estimate, from its World Economic Outlook for May 1998, cites a figure of 6.2%. And the President of Kyrgyzstan in his



TABLE 2. REAL GDP GROWTH IN THE STATES OF CENTRAL ASIA  
SINCE INDEPENDENCE (in % compared to previous year)

|              | 1992  | 1993  | 1994  | 1995  | 1996 | 1997  | 1998<br>1 <sup>st</sup> half |
|--------------|-------|-------|-------|-------|------|-------|------------------------------|
| Kazakhstan   | -13.0 | -15.6 | -18.8 | - 8.9 | 1.1  | 2.0   | 2.1                          |
| Kyrgyzstan   | -16.4 | -16.3 | -20.1 | - 5.4 | 5.6  | 6.2   | 5.0                          |
| Tajikistan   | -31.0 | -27.6 | -15.0 | -12.4 | -4.4 | 2.2   | 2.6                          |
| Turkmenistan | -11.0 | -10.0 | -18.8 | - 8.2 | -3.0 | -23.0 | n.a.                         |
| Uzbekistan   | -11.2 | - 2.3 | - 4.2 | - 0.9 | 1.6  | 2.4   | 4.0                          |

Source: IMF: Kyrgyz Republic (1998), Tajikistan (1998), Turkmenistan (1997), Uzbekistan (1997)-Recent Economic Developments; World Bank, Statistical Handbook: States of the Former USSR (1995); Economist Intelligence Unit, Country Reports, Kazakhstan, Kyrgyz Republic and Tajikistan, Turkmenistan, Uzbekistan, 2<sup>nd</sup> quarter 1998; data for the first half of 1998 compared to January-June 1997 from Interstate CIS Committee on Statistics as it published in "Finansovye Izvestiya", August 6, 1998.

interview published in a Russian newspaper, "Nezavisimaya Gazeta" on April 21<sup>st</sup>, said that real growth was around 5.5 rather than 10% and attributed the discrepancy to statistical methods, which had not yet been brought into line with international standards [see, EIU: Kyrgyzstan, (2<sup>nd</sup> quarter 1998, p.15)]. Data on Kyrgyzstan's GDP in 1997 in the tables 2, 3 and 4 is adjusted according to IMF figure.

As for Uzbekistan's GDP indexes, IMF reported real GDP growth for 1997 as 2.4%, by 2.8% less than official data. However, it mentioned, that the share of the informal sector included in GDP of 6% in 1995 and 10% in 1996 is smaller than in reality. And "deficiencies in the primary data collection methods suggest that the informal sector is likely to be larger" than has been incorporated into Uzbekistan's GDP based on the regular Household Budget Survey. [IMF, (1997 p.16)]. But no adjustments have been made. Having no data for the informal sector's contribution for 1997, it is difficult to judge its real share. Apart from confirming that, in this respect, existing practice in Uzbekistan has much downward bias compared to other republics, which include much larger percentage of the share of the informal sector in their GDP index.

The analysis of data (see, table 2) shows that among the sources of decline, the impact of the disruption of the FSU was the strongest factor. In one year, 1992, the Central Asian Republics lost the from about 11 to 16.4% of their output (Tajikistan's index for 1992-1995 is much bigger because output losses were redoubled due to the civil war). Transitional problems, especially in countries that adopted radical reforms, added additional huge losses of output in 1993-1994 (Kyrgyzstan, Kazakhstan). In Turkmenistan, the continuous fall of output has been connected with problems of marketing gas (non-payment, transit transportation). Uzbekistan managed to cushion better all kind of similar shocks, and since independence has accumulated the smallest decline of GDP. However, it is also clear that the main reason for the drop of output, which happened in the republic to the large extent in 1992 and 1994, was the impact of sharp disruption of trade and financial relations within former FSU. The collapse of the former USSR (December 1991) and unified currency (Russian ruble) zone (1994) together with forced rapid liberalization and difficulties of independent macroeconomic stabilization policy (on the basis of national currency and Central Bank) contributed to the

TABLE 3. GDP IN THE INDEPENDENT STATES OF CENTRAL ASIA,  
IN BLN. US DOLLARS (at purchasing -power parity, PPP)

|              | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 |
|--------------|------|------|------|------|------|------|------|
| Kazakhstan   | 72.4 | 64.7 | 56.0 | 43.0 | 40.1 | 41.5 | 43.2 |
| Kyrgyzstan   | 11.2 | 9.7  | 8.3  | 6.3  | 6.0  | 6.5  | 6.9  |
| Tajikistan   | 9.7  | 7.0  | 5.2  | 4.5  | 4.1  | 4.0  | 4.1  |
| Turkmenistan | 10.5 | 10.2 | 9.5  | 7.7  | 6.8  | 6.8  | 5.3  |
| Uzbekistan   | 48.9 | 44.6 | 44.7 | 43.7 | 44.0 | 45.7 | 47.7 |

Source: UN Economic Commission for Europe, Bulletin for Europe, Vol. 44, 1992; IMF: Kyrgyz Republic (1998), Tajikistan (1998), Turkmenistan (1997), Uzbekistan (1997)-Recent Economic Developments; World Bank, Statistical Handbook: States of the Former USSR (1995); Economist Intelligence Unit, Country Reports, Kazakhstan, Kyrgyz Republic and Tajikistan, Turkmenistan, Uzbekistan, 2<sup>nd</sup> quarter 1998.

TABLE 4. GDP PER CAPITA IN THE INDEPENDENT STATES OF CENTRAL ASIA, IN US DOLLARS (at purchasing -power parity, PPP)

|              | 1991  | 1992  | 1993  | 1994  | 1995  | 1996  | 1997  |
|--------------|-------|-------|-------|-------|-------|-------|-------|
| Kazakhstan   | 4,304 | 3,827 | 3,316 | 2,569 | 2,426 | 2,510 | 2,616 |
| Kyrgyzstan   | 2,524 | 2,164 | 1,863 | 1,405 | 1,339 | 1,427 | 1,513 |
| Tajikistan   | 1,770 | 1,248 | 915   | 783   | 694   | 670   | 685   |
| Turkmenistan | 2,808 | 2,542 | 2,195 | 1,757 | 1,517 | 1,485 | 1,159 |
| Uzbekistan   | 2,342 | 2,089 | 2,048 | 1,963 | 1,956 | 1,994 | 2,013 |

Source: UN Economic Commission for Europe, Bulletin for Europe, Vol. 44, 1992; World Bank, Statistical Handbook: States of the Former USSR (1995); IMF: Kyrgyz Republic (1998), Tajikistan (1998), Turkmenistan (1997), Uzbekistan (1997)-Recent Economic Developments; IMF, World Economic Outlook for May 1998; Economist Intelligence Unit, Country Reports, Kazakhstan, Kyrgyz Republic and Tajikistan, Turkmenistan, Uzbekistan, 2<sup>nd</sup> quarter 1998.

largest (−11.2%) and the second largest (−4.2%) rates of negative growth in Uzbekistan since its independence..

The comparative dynamics of GDP among Central Asian states since independence could be judged also from the data in table 3. Since 1994, Uzbekistan has had the largest GDP (at purchasing -power parity) in Central Asia. Uzbekistan, due to better use of initial conditions and its gradual strategy of transition with a strong state and emphasis on superiority of real sectors (industrial and foreign trade policies) over pure monetarism, neutralized the shocks of desintegration and reforms faster than other countries [see, Islamov, (January 1997, p.p.57–74)]. This opinion later was supported by a French scholar, who emphasized that restricted output decline of Uzbekistan appeared as the combined result of the country comparative advantages (structure of economy with tradable goods, like cotton, gold and other raw material) and the policy adopted by the Government with the early choice of a gradual approach to restructuring and reforms [Brun-Despaigne, (March, 1998, p.p.8–9)]. It is also recognized by an IMF staff report, that “moderate pace of reform has not lead to the sharp changes in production and marketing arrangements that have adversely affected economic performance in many other transition economies” [IMF, (October 1997, p.5)].

TABLE 5. INDEPENDENT STATES OF CENTRAL ASIA AND CIS:  
SECTORS GROWTH INDICATORS (1996 to 1991 in %)

|              | Industrial<br>output | Agricultural<br>output | Capital<br>Investment | Freight<br>Transport* |
|--------------|----------------------|------------------------|-----------------------|-----------------------|
| Kazakhstan   | 49                   | 60                     | 11                    | 20                    |
| Kyrgyzstan   | 36                   | 68                     | 56                    | 5                     |
| Tajikistan   | 40                   | 42                     | 25**                  | 5                     |
| Turkmenistan | 73                   | 71                     | n.a.***               | 64                    |
| Uzbekistan   | 106                  | 84                     | 56                    | 68                    |
| CIS          | 50                   | 68                     | 30                    | 25                    |

\*Without pipelines, \*\*1995 to 1991 in %, \*\*\*not available.

Source: CIS in 1996, CIS Interstate Committee on Statistics, Moscow, 1997, pp.38, 39, 41, 44, 46.

Kazakhstan suffered from deeper and longer decline, in comparison with Uzbekistan. A more rapid recovery was expected in the former, because of the largest amount of FDI in Central Asia in total and the biggest FDI in the FSU per capita, but it has not yet come. And within the first six years of independence, the difference in GDP of two countries has been reversed from -23.5 to +4.5 bln. US dollars in favour of Uzbekistan.

In 1997, GDP was less than half the 1991 level in Tajikistan and only about half the 1991 level in Turkmenistan. As a result of positive growth in Kyrgyzstan in the past two years and a huge decline in Turkmenistan in 1997, the former surpassed the GDP level of the latter both in absolute and per capita terms.

As for GDP per capita (see, table 4), by 1998 Uzbekistan has come closer to the level of 1991 and now it is in the second highest (not second lowest as in 1991) place among five Central Asian states, yielding only to Kazakhstan. But the gap between the two countries has diminished tangibly in this respect more than 3 times, from almost 2,000 to about 600 US dollars. It is also noteworthy, that Uzbekistan managed to reverse negative to positive growth of GDP per capita under continuing substantial growth of total population (at an average 2.2% per year). While in Kazakhstan total population has been decreasing because of the outflow of Russian-speaking people was larger than the natural growth rates of population.

## 2. Real Sectors of the Economy

In comparisons with average CIS indicators in 1996, growth of industrial and agricultural outputs, as well as in capital investment and freight transport (without pipelines), in Uzbekistan was considerably higher, while in Tajikistan and Kazakhstan much less. Turkmenistan had a better position in freight transport, industrial and agricultural outputs. Kyrgyzstan, on the other hand, suffered one of the largest declines (equal to Tajikistan) in freight transport and the largest fall of industrial output in Central Asia, having much less than average CIS indicator on industrial output and equal to it agricultural output index (see, table 5).

As for investment, Uzbekistan and Kyrgyzstan at fifty six per cent were at the same level and much better of compared to other Central Asian states and the CIS average (see, table 5). However, the difference between these two countries is worth mentioning. Uzbekistan's investment was mainly based on domestic savings (about U.S. \$4 billion) with FDI equal to

TABLE 6. INDEPENDENT STATES OF CENTRAL ASIA:  
SECTORAL SHARES OF GDP, 1996 (%)

|              | Agriculture<br>& Forestry | Industry | Construc-<br>tion | Transport &<br>Communi-<br>cation | Trade | Other<br>Services | Total |
|--------------|---------------------------|----------|-------------------|-----------------------------------|-------|-------------------|-------|
| Kazakhstan   | 12.8                      | 21.3     | 3.6               | 9.4                               | 17.1  | 36.8              | 100   |
| Kyrgyzstan   | 32.8                      | 25.4     | 5.9               | n.a.                              | n.a.  | 35.9              | 100   |
| Tajikistan   | 27.7                      | 20.5     | 2.0               | n.a.                              | n.a.  | 49.8              | 100   |
| Turkmenistan | 17.5                      | 50.0     | 13.1              | n.a.                              | n.a.  | 19.4              | 100   |
| Uzbekistan   | 22.5                      | 17.4     | 6.4               | 8.1                               | 7.0   | 38.6              | 100   |

n.a.-data not available, included into other services

Source: IMF: Kyrgyz Republic (1998), Tajikistan (1998), Turkmenistan (1997), Uzbekistan (1997)-Recent Economic Developments; Economist Intelligence Unit, Country Reports, Kazakhstan, Kyrgyz Republic and Tajikistan, Turkmenistan, Uzbekistan, 2<sup>nd</sup> quarter 1998.

U.S. \$825 million. In Kyrgyzstan, it was predominantly connected with foreign loans and investment inflows, which increased sharply and contributed greatly to a huge balance of payments deficit. The share of foreign savings in the total investment in Uzbekistan was 17% and in Kyrgyzstan, 74%.

In most of the republics (excluding Turkmenistan) in 1996, the relative share of agriculture and industries altogether was less than 50% of GDP, while the share of transport and communications, trading and other services increased to more than half of total GDP (see, table 6).

Despite the relative decline of the agriculture's share, it plays significant role in all republics, especially in Kyrgyzstan, Tajikistan and Uzbekistan. It is important in Turkmenistan (cotton) and Kazakhstan (grain) as well, but gas in the former and oil, oil products and metals, trade and services in the latter contribute to the GDP of the countries to a much larger extent. The increased share of services is an objective process of overcoming the distortions of centrally planned Soviet economy. However, all these republics are to large extent agrarian economies and accelerated industrial growth on the basis of new industries and modernization of existing ones is needed to obtain an optimal economic structure.

### *Agriculture*

Agricultural output of CIS countries in 1996 was 68% of the 1991 level. The overall level of agricultural output Tajikistan and Kazakhstan was lower—, in Kyrgyzstan equal to—, Uzbekistan and Turkmenistan higher than the average index (see, table 5). Kazakhstan achieved a tangible increase in grain production in 1997 - 12.3 million tones, compared to the lowest level of 9.5 million tones in 1995, but this was still 2.3 times less than in 1990. Kyrgyzstan had the highest post-independence agricultural output of 1997 for almost all its crops, apart from cotton production which fell by 15% compared to 1996. In Tajikistan, the 1997 cotton harvest was better than that of the previous year with the output of 358,000 tons but was still 2.5 times lower than the 1991 crop. Grain production has been recovering much faster in the past two years due to reallocation of 75,000 hectares of land to rural households. Turkmenistan's agriculture has also seen better performance in grain and cotton production compared with the lowest level of the crops in 1996. However, output of raw cotton (the

second largest source of export revenues) and its yield in 1997 were 2 times less than 1991 crop [EIU, (2<sup>nd</sup> quarter 1998): Kazakhstan (p.25); Kyrgyz Republic , Tajikistan p.p.17 (32); Turkmenistan (p.20)].

Decline in agricultural output of Uzbekistan was less than in other Central Asian states (see, table 5). However, in 1996 the main crops were adversely affected by unfavorable weather conditions. In addition, agricultural performance has been disappointing in a number of respects. Drought, inefficiencies in supply and distribution, and a shortage of spare parts and fuel all contributed to poor grain harvests, noticeably less cotton than in previous years. It was also a signal that the countries need to keep better balance between cotton, grain, vegetables and fruits relying more on their comparative advantages. In 1997, 3.37 million tons of grain, and 3.7 million tons raw cotton were gathered by the farmers of the republic. Out of 1.08 million tons cotton-fibre produced, 978,900 tons was exported which raised 1.58 billion US dollars, or 36% of total 1997 earnings abroad. In 1998, according to preliminary data of the Ministry of Macroeconomics and Statistics of Uzbekistan, the grain crop is 3.76 million tons (annual consumption is around 4.5 million tons) [Reuters, (August 7, 21, 1998)]. And 3.85 million tons of raw cotton and 1.15 million tons of cotton fiber are planned [EIU, (2<sup>nd</sup> quarter, 1998, p.20)]. In the first six months of 1998 compared to the same period of 1997, agricultural output was up 7.4% [RFER, (17/27/98)]. Increase of agricultural production is connected not only with better weather conditions, but also with the progress of reforms and the higher economic incentives given to farmers.

As a whole, in Central Asia changes in agricultural output were connected with an increased share of food plant production. Further development of reforms with more price incentives to farmers, a better legal framework for land and water use are important to promote the labor productivity and living standards of farmers and the rural population in general, i.e. majority of inhabitants of Central Asian states.

### *Industrial Development*

In 1997, as a whole the CIS industrial output decline slowed down. However, in absolute terms industrial production fell to the level of the beginning of the 1970s and was less than 50% of gross industrial output of 1990 (for example, in Russia it was 48%, and in Ukraine-49%). Though all Central Asian republics, apart from Turkmenistan, had positive rates of growth in 1997, industrial production in the majority of them was still low compared to its level in 1990: it was 49% in Kazakhstan, 51% in Kyrgyzstan, and 34% in Tajikistan.

Kyrgyzstan reached the lowest point of decline in 1995 at the second lowest level in the CIS (only after Georgia). In the past two years industrial growth was one of the highest in the CIS. And it was largely due to one enterprise, -a Kyrgyz-Canadian joint venture, which achieved an increase of gold production from 1.5 tons in 1996 to 17 tons in 1997. However the principal industries (light industry, electricity production and others) suffered a continuous decline and 35% of industrial enterprises were producing less in December 1997 than a year before. Kazakhstan's industrial growth in 1997 was lower than was expected, due to decreased prices for the main products (metals and oil). Positive rates of growth in real terms were connected with the good performance of a few joint ventures (f.e., Kazakh-US Tengizchevroil), food production and small and medium enterprises. Tajikistan's post-independence decline of production was halted in 1997. Some recovery observed in economic activity recently, however, has not spread to industrial production. Total output of aluminum, one of

TABLE 7. DYNAMICS OF INDUSTRIAL OUTPUT IN KAZAKHSTAN, KYRGYZSTAN AND UZBEKISTAN, 1990-s (in %)

|            | 1991  | 1992 | 1993 | 1994 | 1995  | 1996  | 1997  |
|------------|-------|------|------|------|-------|-------|-------|
| Kazakhstan | 99.1  | 85.4 | 72.8 | 52.3 | 48.0  | 48.0  | 49.0  |
| Kyrgyzstan | 99.7  | 73.4 | 54.8 | 39.5 | 32.4  | 35.0  | 51.0  |
| Uzbekistan | 101.5 | 94.7 | 98.1 | 99.7 | 100.0 | 106.0 | 112.7 |

Source: CIS Interstate Committee on Statistics, Moscow, 1998, (*Pravda Vostoka*, March 31, 1998, p.2).

the main products, in 1997 did not reach even the level of 1996, which was less than half of the smelter's design capacity. Turkmenistan in 1997 faced the largest decline of industrial production, because of disruption of gas exports and forced decline of gas output to the lowest level for over 30 years. It was about one-fifth of the 1991 level, when the republic produced 84.3 bln. cu m. Gas production, the largest contributor to the GDP of the republic, fell from 35.2 bln. cu m in 1996 (42.7% of GDP) to 17.3 bln. cu m in 1997 (27% of GDP), i. e. its share in GDP declined by more than one half. This led to 27% drop of industrial output. [EIU, (2<sup>nd</sup> quarter 1998): Kazakhstan (p.p.28–29); Kyrgyz Republic, Tajikistan (p.p.16, 31); Turkmenistan (p.22)].

Uzbekistan is the only republic among CIS countries, which in 1995 first reached the 1990 level of industrial output, and in 1996–1997 had exceeded it by 12.7 percent (see, table 7). The republic inherited, relative to Russia and the Ukraine, a smaller share of industrial enterprises, but among the Baltic, Transcaucasian and Central Asian republics (apart from Kazakhstan) it had a rather diversified industrial structure. There were not only light and food industries, but large enterprises of non-ferrous metallurgy, gas, oil and chemical production, machine-building, including defence industries, and others. The lowest output decline (mainly the first year after the break-up of the FSU), rather fast recovery (within three years after independence) and tangible growth recent years are not fully attributed to the size, or peculiarities and comparative advantages of the industrial structure of Uzbekistan. It is true, that republic was able to re-orientate cotton-fiber, gold, copper and some other tradable commodities more easily to countries outside the FSU. But the same products in different proportion and scale were principal items of specialization of other neighboring republics as well (for example, cotton-fibre —Turkmenistan, Tajikistan, gold, uranium-Kazakhstan, Tajikistan, copper—Kazakhstan, gaz— Turkmenistan, Kazakhstan, and etc.). It is also true, that the economies of Kazakhstan and Turkmenistan were more capital-intensive, and Uzbekistan, together with the other two Central Asian republics, had a more labor-intensive economic structure. However, the first two were not so dependent on imports of oil and petroleum products. [for more details on initial conditions see, Islamov, (1991, p.p.7–25)].

So, each republic had its own comparative advantage and disadvantage by the time they had obtained political independence (1991). The main problem under the circumstances was to make full use of the former and avoid negative effects of the latter, choosing an appropriate strategy best suited to meet the challenges, connected with both transition and development.

The most important factor of the better results in Uzbekistan was the strategy to shift towards a more industrialized economy, keeping the traditional and building new industries.

TABLE 8. SHARE OF POPULATION UNDER POVERTY LINE  
(US \$ 4 a Day per Capita at PPP), %

|              | 1987-1988 | 1993-1994 |
|--------------|-----------|-----------|
| Kazakhstan   | 5         | 50        |
| Kyrgyzstan   | 12        | 76        |
| Turkmenistan | 12        | 48        |
| Uzbekistan   | 24        | 29        |

Source: World Bank, World Development Report, 1996

From the first year of independence priority was given to the development of real economic sectors. The policy of energy self-sufficiency (with a rapid increase of oil and oil-products, as well as gas), expansion of value added sub-sectors (automobile production, timber and wood processing), strong growth in metallurgy was successfully combined with import substitution and export promotion. As a whole, the structure of output shares by industry has been changing in favor of heavy industries (machine building and metal production), obtaining features of independent economy and avoiding the drawbacks and dependencies of over-specialization within the the FSU.

The common problem for the majority of Central Asian republics, is their heavy dependence on one product (Kyrgyzstan, Tajikistan, Turkmenistan) or a few (like in Kazakhstan oil, metals) mainly raw materials and transit transportation due to their land-locked geographic location. The strategy of diversification and increase of value added sectors of industries in Uzbekistan is giving better results and helping to diminish the negative effects of both factors.

## V. Concluding Remarks on Impact of Reforms

### 1. Social Aspects

It is too early to draw long term conclusions on the impact of reforms in transitional countries. But it is possible to state that the experience of the first years of reforms in the FSU has seen a direct correlation between radical reforms and a sharp increase of the share of the population under poverty line (see, table 8).

The Central Asian states provide a vivid case study. Kyrgyzstan, which adopted a purely neoclassical "shock therapy approach", resulted in 76% of the population under the poverty line within few years with initial level of 12%. In Kazakhstan the share of this group increased ten times. Uzbekistan's gradual reforms, which permitted all the shocks to be cushioned much move effectively, had the smallest negative change of this index in the FSU, only by 5 percentage points. On the other hand, the delayed reforms in Turkmenistan led to the worsening of the situation rather sharply (for four times) as well.

Of course, there is no automatic correlation between gradualism and the welfare impact. In Uzbekistan, the creation of a socially oriented market economy and the step-by-step transition were two major inter-connected components of the state-led strategy of reforms

[Karimov, (1992, p.37), (1993), (1995)].

Some outside observers consider that Uzbekistan rejected Russian and other post-Soviet versions of radical reforms and adopted the Chinese approach. The main similarity is gradualism and a significant role of state. However, the Uzbek model of transition differs from another well-known example of gradual reforms in China: politically, economically and socially. It was tailored according to the specific circumstances, needs and values of the people of Uzbekistan. Faster political and economic transformation (price liberalization, macroeconomic stabilization, and privatization), but slower so far agricultural and foreign trade reforms. And from the beginning of reforms more attention has been paid to social problems in Uzbekistan compared with China. According to R.Pomfret, in China "regional and income disparities have only recently become a subject of debate (and not yet of decision)" [Pomfret, (1997, p.32)].

## 2. International Aspects

Advisors are almost unanimous that an immediate move to convertibility is the best prescription for countries in transition. That is not a lesson from the postwar reconstruction in Germany. Convertibility took a long time coming and was formally achieved only by 1958. The experience of Japan, according to K Hamada and M. Kasuya, suggests that a unified exchange rate is important to decrease inflation, eliminate complex subsidies for exports and imports, promote exports, and to motivate people to engage into productive activities rather than in speculative shadow operations. And it could be introduced before convertibility under a macroeconomic stabilization program. In Japan a single exchange rate was introduced as early as in April 1949 [see, Dornbusch et al (1993, p.p.X–XI, 173–175, 181)].

The exchange rate policy is an important part of macroeconomic stabilization and systemic transformation reforms as a whole from the viewpoint of integration into the world market and the attraction of foreign investment. The experience of post-Soviet republics shows it is not technically difficult to achieve unified exchange rate and to open up the domestic market. Controversy is connected with their impact on the real economy and other adverse effects (Russia, Kazakhstan, Kyrgyzstan and others).

The most radical trade liberalization introduced in Kyrgyzstan was accompanied not only by the one of the largest decline of industrial production in the FSU and the largest share of people under poverty line, but also by the largest per capita foreign debt (despite the fact that the country received the largest per capita technical assistance both from international and bilateral donors.). Kazakhstan due to the most radical large privatization as for big enterprises, attracted the largest FDI per capita in the FSU. But in comparisons with China and Hungary, that attracted the biggest in absolute term FDI and the largest per capita among all countries in transition respectively, in Kazakhstan FDI was allocated not in labor intensive human resources based enterprises, but capital intensive natural resources based sectors. It is not improving radically employment possibilities, but diminishing the chances for sustainable development for future generations. The economic and social costs of transition in Russia, which has now entered a new round of financial crisis, are apparently, even larger. So radical transition so far has been too costly, made not only at the expense of the majority of the current population but of future generations (huge foreign debt and overuse of non-renewable natural resources) as well.



Uzbekistan has managed to have a more optimal structure of foreign trade and a more diversified FDI. The external debt burden is quite modest, the maturity structure is improved and the share of grants increased in comparisons with 1993. The problem of a multiple exchange rate, however, has remained. In July 1998, the president of Uzbekistan announced, that the republic will take steps in the liberalization of foreign exchange (unification of its rate and convertibility for current account transactions) and sign article VIII of the IMF by the year 2000 [see, Islam Karimov, "Pravda Vostoka", (24 July 1998)]. Thus, the state and people of Uzbekistan have started preparations for the new stage of transformation. Agricultural, foreign trade and public service reforms, development of more mature market institutions and relations, promotion further privatization and industrial policy on the basis of an outward-looking strategy will be the key steps to success in the next stage in transition.

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